

THE CANADIAN CREDIT MEN'S ASSOCIATION LIMITED
SIX CRESCENT ROAD • ROSEDALE, TORONTO 5, CANADA

OFFICE OF THE GENERAL MANAGER

November, 1965

TO THE MEMBERS

The subject of Bankruptcy, particularly where fraud is concerned, is probably the hottest financial news item in the Canadian press across Canada.

Impetus has been added to our cause in combatting Bankruptcy fraud by the tremendous amount of publicity on this subject generated during the current political campaign of the various parties.

We feel encouraged, therefore, that our original brief submitted to the Government in power in March 1962, and successively to each Minister of Justice thereafter, will receive the immediate attention of whichever party is asked to form a Government after November 8th.

Our objective has been materially helped by the Toronto Telegram (circulation 230,000) whose feature writer Stephen Vitunski has covered this subject in some detail. Each of his articles in the series is reproduced on the following pages. It is obvious that the Telegram recognizes the part that CCMA has played and is continuing to play in this important field, as is evidenced by the quotations attributed to Percy J. Houghton, Manager of our National Adjustment Bureau, and the constant references to the Association.

Worthy of note is the prominence given to such members of the legal fraternity as Lloyd W. Houlden, Q.C., W. J. McQuillan Q.C., and Carl H. Morawetz, Q.C., all of whom have given generously of their talents in the interest of the credit fraternity at large, by working with us to reduce Bankruptcy fraud to the minimum.

Yours sincerely,

E. T. C. Burke, F.C.I.
General Manager

This Game Of Bankruptcies

There is nothing wrong with the Bankruptcy Act that a few well-phrased revisions could not solve.

As one bankruptcy lawyer put it, "It's just like a football game. The quarterback spends the first part of the game feeling out the opposition for weak spots, and once they are found, plays are run through the area for big gains."

Unless the opposition adjusts its defenses, it's going to lose by a big margin.

This is true of just about any law ever passed dealing with money. As soon as it's put on the books, armies of specialists pick it up, put it under a microscope and look for loopholes. Most of these people are in the employ of large ethical corporations which figure it's a good way to save money.

A RIDE

However, some of the loop-holes they discover are also used by the unethical operator when he wants to take the government or the public for a ride.

The avowed purpose of the Bankruptcy Act should be, "the expeditious realization of a debtor's assets, and the distribution of the proceeds among the credi-

**This is the first of a series
by Stephen Vitunski
on bankruptcies.**

tors entitled to them in law . . . the punishment of the dishonest debtor . . . and the ultimate discharge of the debtor from bankruptcy, and his integration into society once again freed from a crushing burden of debt."

This is the classic definition given by W. J. McQuillan, a prominent Montreal solicitor familiar with bankruptcy matters. However there is a growing gap between definition and practice.

"Bankruptcy today is big business," said Percy J. Houghton, manager of the Canadian Credit Men's Association Ltd. "Figures for commercial failures alone in Canada reached \$208 million last year," he told a seminar on bankruptcy last May.

FAILURES

In all, there were 5,641 bankruptcies in Canada . . . 2,142 in the wage-earner category and 3,499 commer-

cial failures. The financial losses in the wage-earner category were described by Carl Morawetz, a prominent bankruptcy lawyer, as "peanuts" compared to losses through commercial ventures.

Bankruptcy has become a matter of great concern to businessmen. R. Melville Cox, manager of the Credit Bureau of Greater Toronto gave this example: "When we ran that seminar last May, we expected a turnout of approximately 200 to 225 . . . the usual number for our series. However, when the topic was bankruptcy, 598 persons registered and we had to turn away another 87 applicants."

Who or what is to blame for the mounting toll taken by bankruptcies?

Well, it takes two to do just about anything, and bankruptcy is no exception. It involves a debtor, and a creditor.

"I think there is a terrible amount of loose credit

granting, and I don't think accounts receivable are being followed as closely as they should," observed Mr. Houghton.

WARNING

J. N. McEachran, a past president and Dean of the Canadian Credit Institute, has stated that businessmen have to pay more attention to the four C's of credit . . . "Character, capacity, capital and conditions."

"I believe that where substantial amounts are involved, we are entitled to and should insist on up-to-date financial statements, prepared by accredited accountants."

Lloyd Houlden, of Harries, Houser, Brown & Houlden, was also critical of the eagerness of some businessmen to grant credit to persons of questionable stability. He pointed out that in a recent study of a three-time bankrupt, many of the same names appeared in all three lists of creditors.

CREDITORS

"Many bankruptcies are encouraged by the stupidity and cupidity of creditors," added another bankruptcy specialist heatedly.

Creditors naturally point to the fierce competition of our free-enterprise economy as a major cause for their eagerness to extend credit. "A lot of reputable people hit you with the veiled threat of taking their business elsewhere if you don't want to give them terms," countered a disenchanted creditor.

Monday: To Catch A Thief.

TO RACKETEERS

The Law Is An Asset

By STEPHEN VITUNSKI
Telegram Staff Reporter

One of the main criticisms of the Bankruptcy Act is that it doesn't make sufficient provision for tracking down fraudulent bankrupts.

Second of a Series

For all intents and purposes, the onus is on the creditor to go get 'em. It's a sort of frontier justice where the good guy rides half-way across the plains, spending half his lifetime chasing the jasper that did his brother in when he was a kid.

"If my house is burgled," explained Percy Houghton of the Canadian Credit Men's Association, "I don't have to go down to the police department and put up a retainer before they'll start an investigation. But, if my business is burgled by some bankruptcy crook, I, the aggrieved creditor, am expected to finance the investigation."

COSTLY

In a bankruptcy, investigation requires the services of varied and highly specialized persons . . . all of whom have to be paid by the creditor . . . who has already suffered a substantial loss.

"Debtors have learned that if they work down their assets so that when they go bankrupt there is virtually nothing left, they kill the chances of prosecution," explained Lloyd Houlden of Harries, Houser, Brown and Houlden.

He pointed out that in order to have a successful prosecution, an expenditure of \$5,000 to \$10,000 is needed.

Some other difficulties of prosecution were outlined by Carl Morawetz of Morawetz & Strauss.

"First of all it costs you a lot of money to find out if an offence has been committed under the Bankruptcy Act or under the Criminal Code.

"If there is an investigation, the trustee has to make a report. He then files it with the courts and they give him leave to prosecute. He then sends it to the Crown prosecutor or the Attorney-General, and from that moment on the trustee is pestered day and night to appear here, to appear there, to testify, to appear in court . . . for which the trustee stands to get paid very little if there are few assets left."

INVOLVED

Added Mr. Houlden, "It's necessary to apply to the Bankruptcy Court for leave to prosecute. After that you have to talk the Crown attorney into prosecuting. It's a very involved and expensive procedure.

"In spite of what the Attorney-General might say, we've had some cases during the past year in which the charges were dismissed because of the failure of the Crown to proceed with them . . . and that's a very discouraging thing for people who are engaged in bankruptcy practice."

When things go wrong, there is a natural tendency to look for someone to blame. Files are full of creditors disillusioned with the work of the trustee, of trustees frustrated by creditors, of inspectors fighting with debtors . . . And, almost everyone is mad at the government.

Most of these misunderstandings are based on ignorance of the powers and responsibilities related to the various positions. After all, except for the trustee, most of the others do not get involved in bankruptcies too often, and even if they do, bankruptcies differ widely.

Dealing from the top down, there appears to be sufficient cause for blaming governments for not supplying a more workable framework.

By virtue of the British North America Act, Parliament has exclusive legislative authority over bankruptcy and insolvency.

However, according to former Federal Superintendent of Bankruptcy, J. S. Larose, "the provisions of the Act do not direct the Superintendent to investigate pre-bankruptcy transactions on the possibility that the debtor may have committed fraud. His primary concern is the supervision of the trustee's administration of estates.

This puts the whole problem back in the laps of creditors who have to foot the bill for these investigations. At times, provincial governments step in . . . such as in the Quebec arson and bankruptcy cases . . . to carry the burden usually reserved for the creditor.

"Can you imagine an individual creditor having the time, money, power courage or expertise to conduct the investigations now being handled by the Quebec government?" asked one bankruptcy specialist.

(Tomorrow: The role of trustees, inspectors and creditors.)

Trustee Key In Bankruptcy Case

The key role in any bankruptcy is played by the trustee, almost always a member of the accounting fraternity.

If it is a voluntary bankruptcy, he is appointed by the debtor himself. . . otherwise, the creditors name him.

There has naturally been some question about the propriety of the debtor appointing the person or organization that is supposed to look after the accounts finally accruing to creditors.

The argument on the other side has been that the trustee can be changed at the first meeting of creditors.

However, this has proved extremely difficult to do since it requires a vote representing 75 per cent. of the value of the debt. And, creditors are not noted for acting in unison.

By law, the fee of the trustee is set at 7½ per cent. of the proceeds after payment of secured claims. However, with the consent of inspectors, trustees can apply to the courts and obtain a higher return.

"It's not uncommon to see certain trustees on fairly large estates knocking off 35 per cent. for their fees," explained Percy Houghton of the Canadian Credit Men's Association. However, Mr. Houghton added that he doesn't blame the trustee. . . "he's doing it legally. The ones I blame are the inspectors."

Mr. Houghton went on,

This is the third in a series on bankruptcies by Telegram financial reporter Stephen Vitunski.

"bankruptcy is far too profitable a business for many trustees." The province of Ontario has approximately 240 licensed trustees. . . some 40 more than Quebec.

This has resulted in a scrambling for business. "Some of the trustees, I am convinced, are not competent. Many of them should not have been licensed," he added.

J. N. McEachran, a past president and Dean of the Canadian Credit Institute, added, "It is well known, but difficult to prove, that certain trustees, acting contrary to the act, counsel debtors to make an assignment or proposal.

"For a fee, they permit the debtor to obtain the sanctuary of the Bankruptcy Act, thus defeating his creditors."

Also critical of the role of the trustee was J. S. Larose, former Superintendent of Bankruptcy. Perhaps he was trying to mitigate the shortcomings of the Act he was forced to deal with, but he chided trustees for not always sticking to some of the "clear and explicit provisions of the Act."

"There are those trustees who anticipate their fees either in whole or in part and make unauthorized withdrawals from the estate account," he said in a speech last year.

Mr. Larose was also critical of the slipshod record keeping of some trustees, plus a habit of continuing the administration of an estate indefinitely, "when no useful purpose is served."

INSPECTORS

Trustees, on the other hand, argue with some justification that they cannot do anything without the approval of inspectors appointed by the creditors.

After the first meeting of creditors, their case is usually in the hands of inspectors. These people are elected by the creditors to represent them in dealings with the trustee and debtor.

Unfortunately, the inspectors are either babes in the woods as far as knowledge of bankruptcy procedures are concerned. . . or, they turn out to represent major creditors and therefore work for the benefit of their own company rather than that of the army of creditors in general.

In recent years, there has

been some attempt to remedy this situation by appointing prominent members of credit associations to act as professional inspectors.

TOO FEW

These people know their roles and the extent of their powers, but their numbers are too few.

These powers are impressive, if only they could or would be used. As a matter of fact, practically no action of any consequence may be taken by the trustee without the permission of inspectors.

Inspector verification is required for bank balances, statements of receipts and disbursements. . . right up to the fees and remuneration paid the trustee.

"Not enough of us are willing to serve as inspectors," complained Mr. McEachran. He pointed out that the Bankruptcy Act provides for the appointment of inspectors, "whose main responsibility is to safeguard the interests of the creditors. They, and not the trustee, are responsible for the proper disposal of assets."

"Yet what happens?" asked Mr. McEachran. "It is very difficult to find a creditor willing to act as an inspector, because too many of us take the, 'let George do it' attitude."

Next: Suggested solutions

Revisions Urged, Nothing Done

By **STEPHEN VITUNSKI**
Telegram Staff Reporter

Improvements in the Bankruptcy Act have not been held up for lack of ideas.

Year after year, professional bodies have made submissions to the Minister of Justice, and year after year, these submissions have been pigeon-holed.

Percy Houghton of the Canadian Credit Men's Association pointed out that over the years, his association, in collaboration with prominent lawyers specializing in bankruptcy law, has made repeated representations to the government.

"We have now presented briefs to four Ministers of Justice . . . Davey Fulton, Mr. Fleming, Mr. Chevrier and Mr. Favreau," added Mr. Houghton.

FEDERAL ISSUE

The brief maintains that inasmuch as the Bankruptcy Act is a Federal act, investigation and prosecution of fraudulent bankrupts should be undertaken by the Department of Justice, just as in income tax fraud, combines, and narcotics.

After consultation with the handful of lawyers that specialize in bankruptcy matters, the CCMA formulated a brief outlining procedures for prosecutions under the Bankruptcy Act. It

includes the following items:

A special department should be established under the supervision of the Superintendent of Bankruptcy for the investigation and prosecution of bankruptcy offenses.

Anything turned up by trustees or solicitors could then be passed on to the new body with some assurance that the issue will be fully investigated.

Then, if it is decided to prosecute, a special prosecutor could be hired as is at present done in narcotics and combines investigation cases.

The brief argues that bankrupt estates already pay a two per cent. levy to the Department of Justice for administration of the Act . . . "and by logical extension, this should include policing by way of prosecution."

The specially-established department would have the great advantage of developing men well-versed in the ramifications of the Bankruptcy Act, as well as criminal procedure.

Furthermore, adds the brief, the Superintendent would be able to take the initiative to launch prosecutions where friendly inspectors might be inclined to condone the fraudulent acts of the debtor.

These advantages would

also accrue to special Crown prosecutors assigned to bankruptcy cases. "This would permit them to become familiar with the pattern of bankruptcy cases and to gain the knowledge and background to do an adequate job."

SPECIAL JUDGES

The naming of special judges to hear all prosecutions arising out of bankruptcies was also recommended. They too would then become familiar with bankruptcy frauds involving merchandise shortages, false statements, accounting . . .

The brief also calls for a review of the penalties imposed by some sections of the Bankruptcy Act.

In addition to the inadequacies of the Act itself, there has been growing criticism of the whole concept of the limited liability company. There have been some suggestions to make officers and directors of a company at least partially liable for losses of the entity.

In conclusion, a government body should supply the finances and the bodies to carry out investigations of and prosecutions of fraudulent bankrupts.

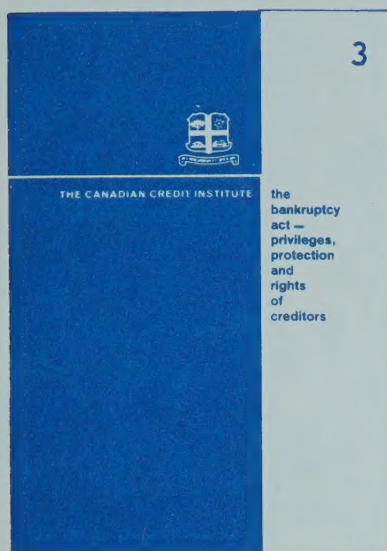
FIGHT

Creditors, trustees and inspectors should acquaint themselves with their roles, and use the full powers granted them. Creditors especially, should be more prepared to fight instead of jumping at a settlement of a few cents on the dollar.

"People just don't seem to mind losing money these days," reflected one credit manager. "At one time there would have been a lynch mob at the crook's door. Now they just shrug their shoulders and walk away."

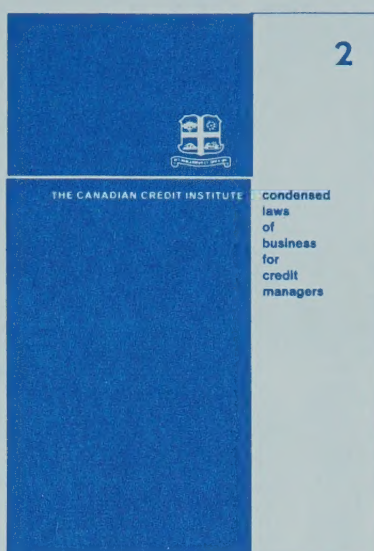
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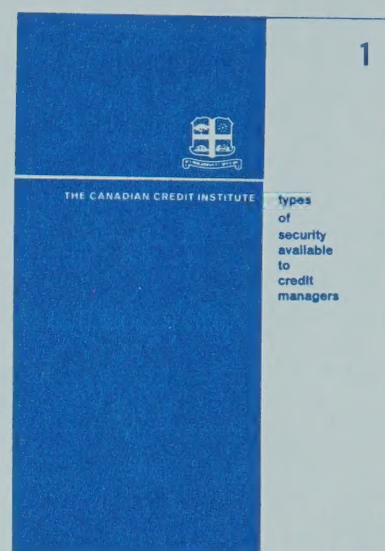
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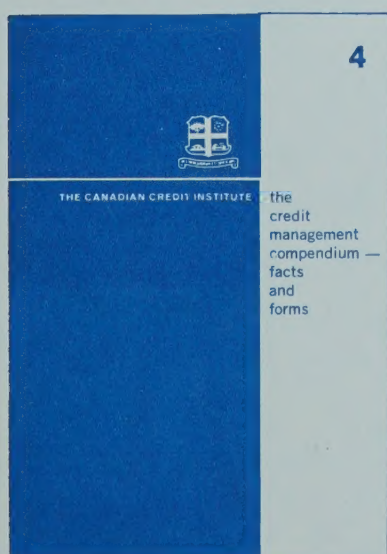
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It has been researched by Mr. P. J. Houghton of The Canadian Credit Men's Association Limited, who has carefully related all the material to the Credit Management function.

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